

Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. (This is a GIL).

September 15, 2003

Dear Xxxxx:

This letter is in response to your letter received March 26, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.1120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

AAA is a STATE based leasing company, which is registered to transact business and bill and collect sales/use tax in your state.

We offer a financing product to our customers referred to as an 'off balance sheet' or synthetic lease transaction.

In an off-balance sheet transaction the customer will depreciate the equipment for IRS purposes on their federal and state income tax return. For financial accounting purposes (GAAP), the customer will treat the off-balance sheet transaction as an operating lease. The only indication of property ownership on the books of the customer will be a footnote on their balance sheet. UCC Financing Statements are filed with customer as the owner and AAA as the holder of the security interest. The monthly 'rental' payments made by customer to AAA are consistent with principal and interest for a typical loan. The customer takes the risk and liabilities of property ownership, as well as risk of loss and the responsibility to maintain the property. The customer indemnifies AAA for all taxes, assessments and fees associated with ownership of the property.

The end of lease provision allows the lessee on the last day of Basic Term to:

A/ Purchase all the equipment for the Purchase Option Price. The dollar amount of the purchase price is stated within the range of 1% to 20% of the cost of the equipment. The purchase option may be Fair Market Value or it may be Fair Market Value not to exceed a stated percentage of the equipment cost or a stated dollar amount.

B/ Terminate the lease and obtain bids for the equipment to sell it to third party. The lessor shall receive all proceeds of the sale and Lessee will pay to the lessor the amount by which the net proceeds of the sale are less than the Purchase Option Price, but no more than the Maximum Lessee Risk.

If the equipment is not sold the lessee will return the equipment to the Lessor and pay to Lessor an amount equal to the Maximum Lessee Risk. (Please see attached documents)

On the purchase of new equipment by AAA to be financed by an 'off-balance sheet' transaction, would sales/use tax be charged to lessee upfront or over the rental stream? If upfront, would tax be based on the equipment cost only or on the total lease receivable? To determine the appropriate sales/use tax treatment, does the State place greater emphasis on the structure of the payment stream and purchase option, or does the State place greater emphasis on the IRS structure? According to the IRS, only the owner of an asset can benefit from depreciation.

On the financing of equipment which was previously purchased and used by the customer for a period of month or years, (sales tax paid to the vendor at time of purchase), would sales/use tax be charged again on the rental stream?

The intent of an 'off-balance sheet' transaction is to allow the customer to remove the asset from their balance sheet for financial accounting purposes only. AAA will not depreciate the asset and has only a security interest in the asset. Will this transaction be treated as a loan for sales tax purposes?

Please send your response to me at

ADDRESS

If you have any questions please call me.

Please see 86 Ill. Adm. Code 130.220. The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases. A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. As end users of tangible personal property located in Illinois, lessors owe Use

Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk